Bundled Transactions – Telecommunications, Audio and Video Programming and Related Services

Sales & Use tax notice #05-19

Public Chapter 782 (2004) and Public Chapter 499 (2005)

Effective July 1, 2005, Public Chapter 499 Acts of 2005 amends Tenn. Code Ann. Title 67, Chapter 6 to conform to Streamlined Sales and Use Tax definitions relative to telecommunications services. Please refer to the department's notice on "Telecommunications" for more information and the 2005 amendments to telecommunications services.

The 2005 amendments in Public Chapter 499 also update the definition and procedures found in Tenn. Code Ann. Section 67-6-539 for certain types of bundled transactions. The procedures for taxation apply to transactions involving Internet access, telecommunications services, and ancillary services and, effective July 1, 2005, to audio or video programming services such as cable, wireless cable or direct-to-home satellite television programming services. These bundled transaction procedures will **not** apply to transactions where other types of services or tangible personal property also are included in the bundled sale of products. The 2005 amended definition for a bundled transaction is:

> For purposes of Section 67-6-539, a "**bundled transaction**" is the retail sale of two or more services, where (1) the services are otherwise distinct and identifiable and (2) the services are sold for one non-itemized price. A bundled transaction does not include the sale of any services in which the sales price varies, or is negotiable, based on the selection by the purchaser of the services included in the transaction.

Example 1: A telephone company sells at retail a package of services for one flat monthly amount of $25. The deal includes local telephone service, Internet access, and four ancillary services: call waiting, caller identification, call forwarding, and voice mail services. The purchaser cannot pick or choose among the different services that are to be included in the bundle. Thus, this is a bundled transaction.

This transaction is for a retail sale of more than one distinct product where the sales price of each of the products was not itemized either in the invoicing given to the purchaser or in the pricing of the products to the purchaser.

Taxation of Bundled Transactions: Prior to Public Chapter 782, Acts of 2004 and Public Chapter 499, Acts of 2005, if a non-taxable product, such as Internet access, was bundled with taxable products, such as local telephone service and ancillary services, the single non-itemized price ($25 in example 1) would be subject to tax. To retain its non-taxable character, the non-taxable service would have to be separately itemized, and the customer must have the option of not purchasing the non-taxable product.

Methods for billing and pricing services to customers continue to change as retailers continue to expand the types of services they provide to customers. While Internet access is not subject to sales tax, ancillary and telecommunications services are subject to different state and local tax rates from cable, wireless cable, and direct-to-home satellite television services. To prevent retailers of these services from being required to collect and consumer from paying more tax than might otherwise have been due because the retailer packaged certain services together for a special price, the following procedures have been adopted for determining the proper taxation for transactions involving telecommunications services, Internet access, ancillary services, and audio and video programming services such as cable, wireless cable and direct-to-home satellite television services.

1) If the bundled transaction is for taxable telecommunications, ancillary and audio video programming services and non-taxable Internet access, tax will be calculated using the total price for the bundled products, unless the seller can document from the seller's books and records the portion of the sales price that is for the non-taxable Internet access.

Sellers, who as a part of their regular business practices account separately in their books and records for the sales of the different products in a bundle, should collect tax only on the sales price apportioned to the taxable products in the bundled transaction. Sellers must use a reasonable method of apportionment. Sellers that do not separately account for bundled products in their books and records **must** collect tax on the single non-itemized price.

The new law also provides for a method to deal with bundles when the telecommunications, ancillary and audio video programming services are taxed at different rates.

Tax Rates -
1) Intrastate
   7% state, 2.5% local
2) Business interstate and international
   7.5% state, no local
3) Residential interstate and international
   7% state, 1.5% local
4) Ancillary service
   7% state, 2.5% local
5) Cable and wireless cable
   $0 - $15 per subscriber – exempt
   $15.01 – $27.5 – 8.25% state, exempt local
   $27.51 and up – 7% state, applicable local
6) Direct-to-home satellite
   8.25% state and exempt local

2) If the bundled transaction is for the purchase of telecommunications, ancillary and audio video programming services that are subject to different state or local tax rates, tax will be calculated using the total price at the higher combined state and local tax rate unless the seller can document from the seller's books and records the portion of the sales price subject to the lower tax rates.

Example 2: A mobile telephone company sells at retail to residential customers a bundle of services for a $45 flat monthly amount. The deal includes a total of 700 minutes for both intrastate and interstate calls, and voice mail services. The company accounts for the sales of each of these products separately in its books and records in the following manner: intrastate sales $20, interstate sales $20 and voice mail $5.

In example 2, tax should be calculated on the apportioned price of the bundled transaction in the following manner:

Intrastate	$20 x 9.5% = 1.90
Residential interstate	$20 x 8.5% = 1.70
Ancillary/voice mail	$5 x 9.5% = .48
Tax Due	$4.08

If the bundled services are not accounted for in the seller's books and records separately, tax must be calculated on the single non-itemized price ($45) at the higher tax rate measured by combining the state and local tax rates together. In example 2, the tax due would be calculated using the state rate of 7% and local rate of 2.5% since the combination of these rates equals the higher rate applicable to one of the services included in the bundle.

Example 3: A cable television company sells at retail to residential customers a bundle of services for a $100 flat monthly amount. The deal includes assorted cable television channels including premium channels and Internet access. The company accounts for the sales of each of these products separately in its books and records in the following manner: cable television services $75 and Internet access $25.

In example 3, tax should be calculated on the apportioned price of the bundled transaction in the following manner assuming the applicable local tax rate is 2.25%:

Cable television - $75		
$15 exempt		= 0.00
$27.50 - $15	$12.50 x 8.25%	= 1.03
$75 - $27.50	$47.50 x 9.25%	= 4.39
Internet access - $25		
Exempt		= 0.00
Tax Due		$5.42

If the bundled services are not accounted for in the seller's books and records separately, tax must be calculated on the single non-itemized price ($100) at the higher tax rate measured by combining the state and local tax rates together. In example 3, the tax due would be calculated using the state rate of 7% and local rate of 2.25% since the combination of these rates equals the higher rate applicable to services included in the bundle. The total tax of $9.25 would be due if the services were not accounted for separately in the seller's books and records.

3) Tenn. Code Ann. Section 67-6-221 provides 4% of the 7.5% state tax collected on business interstate and international telecommunications will be distributed to the Telecommunications Ad Valorem Tax Reduction Fund.

Any seller that either: 1) collects tax on the single non-itemized price for a bundled transaction or 2) taxes it at a higher combined state and local tax rate because the products are not separately accounted for in its books and records, must contact the Department of Revenue for approval to report a portion of the tax collected as funds that should be distributed to the Telecommunications Ad Valorem Tax Reduction Fund.

Effective Date: These procedures applied to bills issued to customers that are dated on or after July 1, 2004, for charges that were not previously billed if the bundled transaction involved only telecommunications services, ancillary services and Internet access. With the 2005 amendments, the procedures will apply to bills issued to customers that are dated on or after July 1, 2005 for charges that were not previously billed if the bundles also involve audio/video programming services such as cable, wireless cable and direct-to-home satellite services. The procedures **do not** apply to transactions where services other than the services mentioned in this notice or tangible personal property are also included in the bundle of products. Such transactions will be subject to tax on the single non-itemized price, and the seller **does not** have the option to apportion the amount subject to tax based on its books and records.

Sellers must continue to separately indicate on invoices or other sales documents given to the customer the amount of tax the customers are paying. Tennessee Rules and Regulations 1320-5-1-.90(1).

If you have any questions about this notice, you may contact the department. Tennessee residents outside the Nashville calling area may call our statewide toll-free number at (800) 342-1003. Callers from Nashville or out-of-state may dial (615) 253-0600. You can access additional formation on our Web site at www.Tennessee.gov/revenue.

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